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REPORT
No. 98–69

THE FEDERAL ANTI-TAMPERING ACT

MAY 2, 1983.—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 216]

The Committee on the Judiciary, to which was referred the bill (S. 216) to amend title 18, United States Code, to combat, deter, and punish individuals who adulterate or otherwise tamper with food, drug, cosmetic, and other products with intent to cause personal injury, death, or other harm, having considered the same, reports favorably thereon with an amendment in the nature of a substitute and recomends that the bill as amended do pass.

I. PURPOSE

The purpose of S. 216 is to amend title 18 of the United States Code to strengthen the Federal law against criminal activities relating to tampering with consumer products. The bill would provide strong penalties for tampering with consumer products with intent to injure individuals or businesses. In addition, it would make it a Federal offense to make false claims about tampering incidents.

II. COMMITTEE AMENDMENT

The committee's amendment in the nature of a substitute strikes everything after the enacting clause and inserts the following:

That this Act may be cited as the "Federal Anti-Tampering Act".

SEC. 2. Chapter 65 of title 18 of the United States Code is amended by adding at the end thereof the following new section:

"§ 1365. Tampering with household products

"(a) Whoever, with intent to kill, injure or otherwise endanger the health or safety of any person or to cause significant damage or injury to the business of an individual, partnership, corporation, association, or other business entity, tampers with and thereby taints, or tampers with and thereby renders materially false or misleading the labeling of, or container for, any household product which is in, is intended to be in, or continues to affect interstate or foreign commerce, or attempts, threatens or conspires to do so, shall—

S573-6

"(1) be imprisoned for not more than ten years or fined not more than $20,000, or both;

"(2) if serious bodily injury results, be imprisoned for not more than twenty years or fined not more than $50,000 or both; and

"(3) if death results, be imprisoned for any term of years or for life or fined not more than $100,000, or both.

"(b)(1) Whoever imparts or conveys false information, knowing the information to be false, concerning an act or attempted act which, if true, would constitute a violation of subsection (a) shall be imprisoned for not more than one year or fined not more than $10,000, or both.

"(2) Whoever willfully and maliciously imparts or conveys false information, knowing the information to be false, concerning an act or attempted act which, if true, would constitute a violation of subsection (a) shall be imprisoned for not more than five years or fined not more than $25,000, or both.

"(c) A violation of this section may be investigated by the Federal Bureau of Investigation and by any other Federal agency which has investigative jurisdiction over such violation under title 21 of the United States Code.

"(d) A person has the intent required for an offense under this section if the person knows or has reason to know that the normal and usual consequence of the actual, attempted, planned, or threatened tampering would be to kill, injure, or otherwise endanger the health or safety of any person or to cause significant damage or injury to the business of an individual, partnership, corporation, association, or other business entity.

"(e) As used in this section—

"(1) the term 'household product' means—

"(A) any food, drug, device, or cosmetic; or

"(B) any article, product, or commodity of any kind or class which is customarily produced or distributed for sale through retail sales agencies or instrumentalities for consumption by individuals, or use by individuals for purposes of personal care or in the performance of services ordinarily rendered within the household, and which usually is consumed or expended in the course of such consumption or use;

"(2) the term 'food' has the definition given such term in section 201(f) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(f)) and also includes 'meat food product' as such term is defined in section 2(j) of the Federal Meat Inspection Act (21 U.S.C. 601(j)), 'poultry' as such term is defined in section 4(e) of the Poultry Products Inspection Act (21 U.S.C. 453(e)), 'poultry product' as such term is defined in section 4(e) of the Poultry Products Inspection Act (21 U.S.C. 453(f)), 'egg product' as such term is defined in section 4(f), of the Egg Products Inspection Act (21 U.S.C. 1033(f)), and 'egg' as such term is defined in section 4(g) of the Egg Products Inspection Act (21 U.S.C. 1033(g));

"(3) the term 'drug' has the definition given such term in section 201(g)(1) of the Federal Food, Drug, and Cosmetic Act, (21 U.S.C. 321(g)(1));

"(4) the term 'device' has the definition given such term in section 201(h) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(h));

"(5) the term 'cosmetic' has the definition given such term in section 201(i) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(i));

"(6) the term 'labeling' has the definition given such term in section 201(m) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(m)); and

"(7) the term 'serious bodily injury' means bodily injury to a person which involves—

"(A) a substantial risk of death;

"(B) extreme physical pain;

"(C) protracted and obvious disfigurement; or

"(D) protracted loss or impairment of the function of a bodily member, organ, or mental faculty.".

SEC. 3. The table of sections at the beginning of chapter 65 of title 18 of the United States Code is amended by adding at the end thereof the following new item:

"1365. Tampering with household products.".

Amend the title of the bill to read as follows:

To amend title 18, United States Code, to combat, deter, and punish individuals who tamper with household products with intent to cause personal injury, death, or other harm, and for other purposes.

III. Purpose of the Committee Amendment

The amendment adopted by the committee, in addition to making technical and stylistic improvements in the bill, addresses certain concerns raised by the Justice Department and other witnesses who testified at the committee's hearing on March 4, 1983. The amendment makes the following substantive changes in the bill, which are discussed in more detail in section VI infra:

1. It includes tampering with the labeling of, or container for a product. S. 216, as introduced, covered only tampering with the product itself.

2. It includes threatening and conspiring to tamper. Under S. 216, as introduced, conspiracies to commit tampering offenses would have been punished under the general conspiracy provision, 18 U.S.C. 371, with lower penalties. Furthermore, under the bill as introduced, while false claims would have been punished, a genuine threat to commit an offense would not have been.

3. It includes a more graduated penalty structure and increases some penalties for tempering.

4. It includes a misdemeanor "false claim" offense, similar to the one which applies to aircraft hijacking (49 U.S.C. 1472(m)). S. 216, introduced, would have punished false claims only where the offender as exhibited a "willful and malicious" intent.

5. It removes the requirement included in the bill as introduced that a false claim lead to certain results, such as a government recall of a product, to make the provisions more analogous to existing false claims provisions, such as those relating to aircraft hijacking.

6. It lowers the term of imprisonment and raises the fine applicable to willful malicious false claims.

7. It clarifies investigative authority on the part of Federal agencies which would have concurrent jurisdiction under title 21.

8. It defines specific intent to include situations where the offender knows or has reason to know that the normal and usual consequences of the tampering would be personal injury, death, or significant damage to business.

9. It limits the products covered to food, drugs, devices, cosmetics or other products customarily produced for individual consumption or individual use for personal care or in the performance of household services and which usually are consumed or expended in the course of such consumption or use.

10. It limits the intent to cause damage to business "significant damage.

11. It substitutes "taints" for "adulterates" and "renders materially false or misleading" for "misbrands." The terms "adulteration" and "misbranding" apply only to food, drugs, cosmetics and devices, as those terms are used in the Federal Food, Drug, and Cosmetic Act. Since S. 216 covers other products, the use of those terms is not appropriate.

IV. Background

Between September 30 and October 2, 1982, seven deaths were reported in the suburbs of Chicago following the ingestion of Extra-Strength Tylenol capsules laced with potassium cyanide. The

manufacturer, McNeil Consumer Products Co., a subsidiary of Johnson & Johnson, in a series of actions, ultimately recalled all Tylenol and Cotylenol capsules, which were not in blister pack, throughout the United States, In all, 31 million bottles of these over-the-counter pain relievers were withdrawn from retailers, wholesalers, and the public as a result of the Chicago crisis. The company has estimated the cost of warnings to the public, recall, testing, and destruction of capsules to have been $100 million.[1]

Although the perpetrators of the Chicago incident have apparently not been found, it is hypothesized that one or more persons purchased the capsules, tampered with them, reinserted the capsules into the bottles and boxes in which they were sold, and then surreptitiously placed them on the store shelves from which the victims purchased them.[2]

The Chicago tragedy was well publicized throughout the Nation. Johnson & Johnson received at least one extortion threat and two arrests were subsequently made. Three days after the last death, the company was advised that three bottles of Extra-Strength Tylenol capsules had been tampered with by inserting strychnine. No fatalities resulted.[3]

In addition to the "fall-out" experienced by Johnson & Johnson, a wave of other "copycat" crimes was reported. On October 13, 1982, four retailers received phone calls reporting that milk manufactured by the Lawson Co., in Cuyahoga Falls, Ohio, was poisoned.[4] There have been reported incidents relating to oral hygiene products contaminated with acid, other drug products laced with rat poison, acid, and lighter fluid, insecticides mixed with beverages, and pins, needles, and other dangerous items inserted into food products throughout the country.[5]

The Food Safety and Inspection Service of the Agriculture Department reports that it has been involved in several such incidents, including the following:

1. A person, later apprehended, falsely informed various people that he had contaminated meat at a Kansas processing esstablishment with arsenic, cyanide, and LSD. At one point, 3 million pounds of meat product had to be held in cold storage while the investigation was conducted. Several hundred samples had to be tested. Precautions were taken in all 13 of the company's plants.

2. When two students at an elementary school discovered needles in their hot dogs, the local law enforcement agency had to confiscate and destroy 100 pounds of suspect product. Several thousand pounds of that product were detained at the processing plant.

3. A poultry plant received a phone call saying that someone had deliberately contaminated their processing water. Samples had to be

[1] "Tamper-Resistant Packaging for Over-the-Counter Drugs: Hearing Before the Subcommittee on Health and the Environment of the House Committee on Energy and Commerce," 97th Congress, 2d session (hereinafter "House Commerce hearing") at 57–59 (statement of David E. Collis); written testimony by D. Lowell Jensen, Assistant Attorney General, U.S. Department of Justice, before the Senate Committee on the Judiciary, concerning S. 216, the Federal Anti-Tampering Act (Mar. 4, 1983) (hereinafter "Justice Department Testimony") at 3, citing, FDC Reports vol. 44, No. 46, at 8 (Nov. 15, 1982).

[2] Written statement by Johnson & Johnson for the record of the Senate Judiciary Committee concerning S. 216 (Mar. 4, 1983) at 1–2.

[3] House Commerce hearing at 58–59.

[4] Meyer, "The Poison Problem," Forbes 34 (Dec. 20, 1982).

[5] Written statement of the Grocery Manufacturers of America, Inc., in support of proposed criminal anti-tampering legislation (S. 216) before the Senate Judiciary Committee (Mar. 4, 1983) at 3.

flown to a government laboratory to screen for a wide range of potential poisons. Several hundred thousand pounds of poultry meat were detained from distribution, but no contaminated water or poultry was discovered.[6]

Next to the Tylenol incident, the most devastating situation occurred with respect to Ball Park hot dogs manufactured by the Hygrade Food Products Corp. of Southfield, Mich. Following complaints by several consumers that they had found razor blades in their hot dogs, the company recalled 350,000 pounds of the product and spent a frantic weekend putting them through metal detectors. Although the initial complainant ultimately confessed that she had put the razor blade into the hot dog herself, the incident cost the company approximately $1 million in recall costs and lost profits. By contrast, its annual profit is approximately $8 million.[7]

Although the Tylenol situation generated public attention on this phenomenon, it was not the original case. Cases were reported at the turn of the century. See for example, *Runnels* v. *State*, 45 Tex. Cr. R. 446, 77 S.W. 458 (1903) (strychnine added to tub of syrup). In late 1979, the owner of a small grocery store outside of Portland, Ore., was told that there were poisoned items on his shelves. The same extortionist was involved in a similar scheme concerning poisoned pickles in California. While the FBI was working on five separate cases in that year, they feared that they were hearing about fewer than half of the schemes that had taken place.[8]

In the 97th Congress, soon after the Tylenol tragedy, Judiciary Committee Chairman Strom Thurmond, Republican, of South Carolina, introduced S. 3048, which ultimately enjoyed the cosponsorship of 50 U.S. Senators. The bill was reported to the Senate without amendment, and passed, with an amendment, by voice vote on December 17, 1982. The amendment, sponsored by Senator Patrick J. Leahy, Democrat, of Vermont, graduated the penalties for false claims offenses and made them punishable only where death, personal injury, sustained fear for personal safety, product recall, or other serious public disruption resulted.

Because of the press of business at the close of the 97th Congress, the House of Representatives did not pass separate legislation and the Tylenol bill was included in a larger anticrime package, H.R. 3963. As a result of the preference expressed by some House conferees on that bill that, in the absence of House hearings, the tampering provisions should be limited in scope, the version ultimately sent to the President was more restrictive than S. 3048. It only covered tampering with food, drugs, devices, or cosmetics which at any time affected interstate or foreign commerce and which were produced or distributed for consumption or use by individuals, where the offender intended to cause the death of, or bodily injury to, an individual and where death or serious bodily injury resulted. Attempts were also punishable. The maximum penalties for an attempt were a $20,000 fine and/or 5 years of imprisonment. Where death or serious bodily injury resulted, the maximum penalties were $100,000 and/or life imprisonment. In other cases, the maximum term of imprisonment was 20 years. Pri-

[6] Letter from Donald L. Houston, Administrator, Food Safety and Inspection Service, U.S. Department of Agriculture, to Hon. Strom Thurmond, chairman, Senate Judiciary Committee (Mar. 16, 1983).
[7] Colvin, "Lessons from a Hot Dog Maker's Ordeal," Fortune 77–82 (Mar. 7, 1983).
[8] Meyer, supra note 4, at 34.

marily because of concerns about other portions of the anticrime package, the President pocket vetoed the bill on January 17, 1983.

On January 27, 1983, at the first opportunity in the 98th Congress, Chairman Thurmond reintroduced tampering legislation. S. 216, as introduced, was identical to the bill which passed the Senate on December 17, 1982.

V. Committee Action

On March 4, 1983, Chairman Thurmond chaired a hearing before the full Committee on the Judiciary on S. 216. The committee received testimony from Hon. D. Lowell Jensen, Assistant Attorney General in charge of the Criminal Division of the Department of Justice, and witnesses from a wide variety of affected industries.

At that hearing, all witnesses generally testified in strong support of the bill. The Department of Justice observed that the results of actual and false tampering incidents had been "profound and tragic." In addition to death and injury, the Department noted the inconvenience to consumers, their loss of confidence in over-the-counter products, "enormous" financial loss to manufacturers, decreased competition, and lost jobs. These results, in the Department's estimation, made product tampering "an appropriate matter for national concern." The Department noted that local and State law enforcement authorities in such situations might be limited in their ability to conduct investigative and prosecutorial functions.

While the Department cited existing provisions of the Federal Food, Drug, and Cosmetic Act which might cover some of the conduct and problems that it outlined, it noted that the penalties provided under that act are inadequate. The Department made several suggestions aimed at improving the bill, most of which were incorporated into the amendment in the nature of a substitute adopted by the committee and discussed in more detail in the section-by-section analysis infra.

Representatives of the affected industries also testified in strong support of the bill. In particular, they stressed the urgent need for Federal legislation which would cover false claims and conduct aimed at damaging a business.

Based on the testimony received at that hearing, the committee, on April 12, 1983, with a quorum present, by voice vote and without objection, ordered the bill favorably reported, with an amendment in the nature of a substitute offered by Chairman Thurmond.

VI. Section-by-Section Analysis

The following is a section-by-section analysis of S. 216, as it was reported by the Committee on the Judiciary:

The title of the bill, as reported, reflects the changes made by the amendment in the nature of a substitute.

SECTION 1

Section 1 of the bill sets forth its short title: the Federal Anti-Tampering Act.

SECTION 2

Section 2 of the bill amends chapter 65 of title 18 of the United States Code to add a new section 1365 entitled "Tampering With

Household Products." That section sets out the elements of the offenses, the penalties for committing the offenses, the jurisdictional requirements, and definitions.

As introduced, S. 216 would have created a new chapter 56 in title 18 relating to "Adulteration." The committee felt that the creation of a new chapter was unnecessary since the offense appropriately belonged in existing chapter 65, which relates to "Malicious Mischief."

Proposed section 1365(a) makes it an offense to (1) tamper with and taint, or (2) tamper with and render materially false of misleading the labeling of, or container for, certain "household products." The conduct must be engaged in with an intent to kill, injure or otherwise endanger the health or safety of any person or to cause significant damage to a business, as that intent is defined in subsection (d). The household product must be in, intended to be in, or continue to affect interstate or foreign commerce. Attempts, threats, and conspiracies to engage in the prohibited conduct are also punishable.

The concept of tampering is well defined in the common law and in common usage:

> * * * "Tamper" is a word of common usage and of general understanding. The definition of the word itself connotes secrecy and scheming or plotting. *State* v. *Ridinger*, 364 Mo. 684, 266 S.W. 2d 626, 630 (1954). It is defined in Webster's New International Dictionary (Merriam), 2nd Edition as: "3. To meddle so as to alter a thing; esp. to make corrupting or perverting changes, as to tamper with a document or a text; to interfere with improperly." The term "tamper," when used in a criminal statute "has the limited meaning of improper interference 'as for the purpose of alteration, and to make objectionable or unauthorized changes.'" *Keefe* v. *Donnell*, 92 Me. 151, 42 A. 345, 348 (1898).

State v. *Harlston*, 565 S.W. 2d 773, 778–79 (Mo. 1978).

"Tampering" would not include the manufacturing of a product which was inherently dangerous since that conduct would not involve meddling with or perversion of a product. However, it would include, for instance, tampering by an employee at the manufacturing stage. Tampering involves changing a product from what it was intended to be by the manufacturer.

In some cases, tampering has been held to include theft as well. See, for example, *People* v. *Anderson*, 126 Cal. Rptr. 235, 543 P. 2d 603 (1975). For this reason, the proposed section 1365(a) requires that the tampering conduct lead to a specified, undesirable result. In the case of tampering with a product, the reported bill requires that that conduct result in a "tainting" of the product.

According to common usage, to "taint" is to modify with a trace of something offensive or deleterious, or to infect, contaminate, or corrupt.[9] Thus, under the committee's version, the tampering activity must lead to a contamination of, or addition of something offensive to, the household product. Such an "offensive" or "contaminating" result would be the addition of an unsightly or nauseating substance, as well as a dangerous substance.

[9] "The Random House College Dictionary" (Rev. Ed. 1980).

As recommended by the Department of Justice,[10] the committee's reported bill includes tampering with the label of, or container for, a household product. As introduced, S. 216 covered only tampering with a product. It would not have covered the situation where the label or container of a toxic substance, such as acid, was altered to indicate that the product was an inherently safe one. The bill specifically requires that the label or container be rendered materially false or misleading. Thus, an insignificant tampering with the label would not be covered under this offense, irrespective of the malicious, but misguided, intent of the tamperer. The Justice Department's proposal did not spell out "a materiality" requirement, although the Department's witness at the March 4, 1983, hearing testified that it was not intended to cover nonmaterial alterations.

The conduct punishable under subsection (a) must be engaged in with a specific intent "to kill, injure or otherwise endanger the health or safety of any person or to cause significant damage or injury to the business of an individual, partnership, corporation, association, or other business entity." As defined in proposed subsection (d), such intent would also include the situation where the offender knew or had reason to know that the normal and usual consequence of his conduct would be the specified results. Subsection (d) is discussed in more detail infra.

Unlike some other versions of this legislation, see, for example, H.R. 3963, supra, the committee's bill punishes tampering conduct in which the offender engages with an intent to damage a business. Thus, it would cover tampering which was not intended to, nor which would forseeably, cause death or injury to individuals, such as tainting a product with an unsightly dye. Witnesses from affected industries were universal in strong support for this provision.

The committee chose to include this offense for several reasons. First, conduct could conceivably result in a major loss to business due to the costs of investigation needed to ascertain whether it was indeed a harmless adulteration. Second, the effect on consumer buying patterns would be similar and "copycats," including those whose tampering activities would pose a danger to life and health, would be encouraged. The rumors generated could have a substantial adverse impact. Third, the law frequently punishes intentional or knowing damage to business, such as embezzlement. Many Federal statutes prohibiting tampering with other items apply whether or not there is a showing of intent to cause bodily injury to passengers.[11] Finally, since current provisions in the Food, Drug and Cosmetic Act, 21 U.S.C. 301 et seq., already punish this behavior, proposed section 1365(a) does not create a new offense with respect to the vast majority of the products covered. Howerev, it does substantially and appropriately raise the penalties for such conduct.

The only testimony received by the committee against the provision in S. 216, as introduced, which includes tampering with intent to damage a business reputation was from the Justice Department. The Department was concerned that it would reach instances "in which no

[10] Justice Department testimony at 7.

[11] See, e.g., 18 U.S.C. 2271 (conspiracy to destroy a vessel with intent to injure insurer); 18 U.S.C. 32 (causing aircraft or spare part to be unworkable with intent to disable aircraft); 18 U.S.C. 1992 (making a train track or warehouse unusable with intent to disable a train).

physical harm to a person was contemplated or could result, for example, putting a harmless purple dye in orange juice." While the Department acknowledged that such conduct was already covered under the Food, Drug, and Cosmetic Act where it constituted "adulteration" it felt that such conduct did not merit the same severe punishment, and was unlikely to result in as much harm to business reputation, as conduct involving tampering that may injure or take human life. Finally, the Department was "not aware of any pattern of incidents of this kind which would be likely to require investigation by the Federal Government." [12]

By adopting the Department's recommended penalty structure, the committee's bill insures that conduct which does not result in personal injury or death will not be punished at that level. Furthermore, although most instances to date have involved actual or alleged harmful substances, it would be inadvisable to underestimate the ingenuity of the criminal mind, particularly in view of the aforementioned devastating results of such conduct.

While the committee chose to retain the "damage to business reputation"-type offense in the bill, it did make two improvements aimed at addressing the concerns described above. First, the offense now involves an intent to damage a "business," rather than a "business reputation." The former clearly includes the latter, which will be a clearer intent for the prosecution to prove. Second, the bill reported by the committee requires that the intended damage to the business be "significant." This precludes the possibility of prosecution where the offender intended, or had reason to believe his actions would result in, mild annoyance.

As introduced, S. 216 requires that the "act of adulteration or tampering occur before the product is introduced or delivered for introduction into interstate commerce, while the item is in interestate commerce, while the item is held for sale (whether or not the first sale) after shipment in interstate commerce, or if the act of adulteration or tampering otherwise affects interstate commerce." The bill reported by the committee essentially adopts the simpler commerce nexus suggested by the Department of Justice and includes foreign commerce. Thus, it covers any household product "which is in, is intended to be in, or continues to affect interstate or foreign commerce."

With the exception of the inclusion of foreign commerce, the committee's adoption of the Justice Department's recommended language is not intended as a substantive change.[13] Both versions start Federal jurisdiction in the manufacturing stage and retain it through the retail process. Neither version would cover tampering within the home where the bottle is not, or is not intended to be, placed on the retail shelf. Thus, the original goal of S. 216 to limit Federal jurisdiction to cases which are not more appropriately left to State and local jurisdictions is preserved.

The Food, Drug, and Cosmetic Act makes it a Federal offense to engage in certain acts involving "adulterated" or "misbranded" food, drugs, cosmetics, or devices. Specifically, it is an offense to:

(1) Introduce or deliver for introduction into interstate commerce any adulterated or misbranded substance,

[12] Justice Department testimony at 8–9.
[13] Id., comparison between S. 216 and DOJ draft bill at 1–2.

(2) Adulterate or misbrand a substance in interstate commerce,

(3) Receive in interstate commerce an adulterated or misbranded any adulterated or misbranded substance.

(4) Manufacture within a U.S. territory an adulterated or misbranded substance, or

(5) Do any act with respect to a substance if that act is done while the item is held for sale after shipment in interstate commerce and results in the item being adulterated or misbranded.

21 U.S.C. 331 (a), (b), (c), (g), (k).

The maximum penalty for any such offense is 1 year of imprisonment and/or a $1,000 fine, 21 U.S.C. 333(a), unless the person has been previously convicted of an offense under 21 U.S.C. 331 or committed the offense "with the intent to defraud or mislead." Under those circumstances, the maximum penalty is 3 years of imprisonment and/or $10,000. The latter penalty would probably apply in most tampering cases since an "intent to defraud or mislead" would presumably be present. A conspiracy to commit such an offense would be punishable by a maximum penalty of 5 years of imprisonment and/or a $10,000 fine under 18 U.S.C. 371. Attempts to commit an offense are not punishable. In addition to the fact that the Food, Drug, and Cosmetic Act does not apply to all products which might be attractive to a potential tamperer, as the Department of Justice and other witnesses before the committee testified, the penalties provided are clearly inadequate to deter this type of activity.

As introduced, S. 216 would have made a tampering offense punishable by maximum penalties of 20 years of imprisonment and/or a $20,000 fine, unless personal injury to, or the death of another resulted. In the latter instance, the maximum penalty was imprisonment for any term of years or for life. As reported by the committee, the bill adopts the penalty structure recommended by the Department of Justice. Thus, the basic maximum penalty is 10 years of imprisonment and/or a $20,000 fine. If serious bodily injury results, the maximum is 20 years of imprisonment and/or a $50,000 fine. Finally, if death results, the maximum penalty is imprisonment for any term of years or for life and/or a $100,000 fine. Attempts, threats, and conspiracies are punished at the same level as an actual offense.

The penalties contained in the bill reported by the committee are designed to reflect the harm resulting from the prohibited conduct. Specifically, they are graduated based on whether the offense causes serious bodily injury or death. The concept of basing penalties on the harm that results is well established in existing law. See, for examples, 18 U.S.C. 844 (d), (f), (i) (explosives offenses).

The committee's language adopts the concept of "serious bodily injury," rather than "personal injury," in the grading of penalties. S. 216, as introduced, would have made conduct resulting in "personal injury" punishable by life imprisonment. These penalties were high for situations where the resulting harm fell short of "serious bodily injury." The committee felt that 10 years of imprisonment and/or a $20,000 fine were substantial penalties for such conduct and that stronger penalties would be appropriate only where more serious harm were the result.

The fines recommended by the committee recognize the fact that the fines for many current title 18 offenses are too low to provide adequate

deterrence. The fine levels contained in the committee's reported bill are more in line with those enacted in recent years. See, for example, 18 U.S.C. 2318 (trafficking in counterfeit audio and visual works); 18 U.S.C. 2319 (criminal infringement of copyright); 18 U.S.C. 831 (prohibited transactions involving nuclear materials).

As discussed in more detail above, the specific reference to a conspiracy offense raises the penalties for such an offense, since it precludes the application of the penalties applicable under 18 U.S.C. 371; that is, 5 years of imprisonment and/or a $10,000 fine.

Proposed 18 U.S.C. 1365(b) contains the "false claim" or "hoax" offenses. Subsection (b)(1) makes it an offense to impart or convey false information, with knowledge that the information is false, concerning an act or attempted act which would constitute a tampering offense under subsection (a), if true. Such an offense would be a misdemeanor punishable by a maximum term of imprisonment of 1 year and/or a $10,000 fine. If the offense were committed "willfully and maliciously," proposed subsection (b)(2) would provide for maximum penalties of 5 years of imprisonment and/or a $25,000 fine.

Under S. 216, as introduced, making a false claim would have been punishable only where the offender possessed a "willful and malicious intent." In addition, such conduct would only have been an offense where personal injury, death, sustained fear for personal safety, a government or private sale prohibition against or recall of the product or other "serious disruption to the public" resulted. The maximum penalties would have been life imprisonment where personal injury or death resulted and 20 years of imprisonment and/or a $20,000 fine in any other case. These provisions were adopted on the floor of the Senate in the 97th Congress because of a concern that such substantial penalties would not be appropriate in cases where significant harm did not result.

In recognition of that concern, the bill reported by the committee substantially lessens the penalties for a false claim offense so that they are analogous to existing provisions relating to false claims for hijacking and bomb threats. 49 U.S.C. 1472(m); 18 U.S.C. 844(e). Thus, the prosecution will not be faced with the difficult burden of proving beyond a reasonable doubt an additional element of the offense. Furthermore, criminal liability will not be triggered by a subjective act by a private person such as a recall or products or "sustained fear." Finally, the presence of a misdemeanor offense which does not require proof of a "willful and malicious" state of mind will preclude the defense that the offender was "only kidding" when a resonable person would interpret the expression as serious under the circumstances. The committee anticipates that, as with the analogous hijacking and Presidential threat offenses, the courts will interpret the offense under the first amendment to require that the expression be such that a reasonable person would interpret it as serious. See, for example, *Watts* v. *U.S.*, 394 U.S. 705 (1968) (Presidential threats); *U.S. v. Irving*, 509 F. 2d 1325 (1975) (hijacking).

Proposed subsection (c) would authorize the investigation of an offense under section 1365 by the Federal Bureau of Investigation. In the Tylenol cases, the FBI provided investigative assistance after the Attorney General exercised his power under 28 U.S.C. 533(1) to provide such assistance in connection with nontitle 18 criminal offenses.

However, as the Justice Department witness observed during the March 4, 1983, hearing, such assistance is only provided on an ad hoc basis. Proposed subsection (c) would permit FBI involvement in appropriate cases without undue bureaucratic hardship.

In addition, under the proposed subsection, other Federal agencies with investigative jurisdiction over a violation under title 21 of the United States Code would share concurrent investigative jurisdiction. This provision was included at the suggestion of the Department of Justice in recognition of the fact that relevant Federal regulatory agencies have an interest in such matters and could provide expertise which would be of assistance in the successful solution of these cases.[14] The provision does not, however, grant investigative jurisdiction over offenses which would not also be offenses under title 21. For instance, the Food and Drug Administration would not have jurisdiction to investigate a false claim offense concerning Tylenol once it becomes clear that a false claim is involved. Similarly, the Department of Agriculture would not be authorized to continue to investigate what turns out to be a hoax concerning meat products. The jrisdictional division is analogous to the situation where a fire department responds to a call. When it becomes clear that it was a false one, the police department takes over. Finally, this provision would not alter the division of responsibilities between those two agencies as that division is set forth in title 21.

Proposed subsection (d) provides that a person has the intent required for an offense under the proposed section if the person knows or has reason to know that the "normal and usual consequence" of the actual, attempted, planned, or threatened tampering would be any of the results required under subsection (a). This provision was also included at the suggestion of the Department of Justice to insure that an offender would not escape punishment on the ground that he did not specifically intend the results required in subsection (a) because he planned to reveal that the product was dangerous before damage occurred, or merely intended to play a joke. The committee concurs with the sentiment expressed by the Justice Department that where the perpetrator knowingly places lives in jeopardy, he has engaged in conduct sufficiently dangerous to warrant the imposition of criminal sanctions.[15]

Proposed subsection (e) contains the definitions applicable to section 1365. The term "household product" essentially covers two categories. First, it includes any food, drug, device, or cosmetic, as those terms are defined in the Food, Drug and Cosmetic Act. Second, it covers any article, product, or commodity which is customarily produced or distributed for sale through retail sales agencies or instrumentalities for consumption by individuals, or for use by individuals for purposes of personal care or in the performance of services ordinarily rendered within the household and which usually is consumed or expended in the course of such consumption or use. The use of the word "household" is not intended to exclude from the bill's coverage items used outside the home, such as restaurant foods, which are otherwise covered by the definition.

As introduced, S. 216 would have covered, in addition to the first category of products, "hazardous substances," as defined in the Federal

[14] Id., at 8.
[15] Id., comparison between S. 216 and DOT draft bill at 2.

Hazardous Substances Act (15 U.S.C. 1261(f)), and "any other article, product, or commodity of any kind or class which is produced or distributed for consumption by individuals or use by individuals for purposes of personal care or in the performance of services rendered within the household." That language presented several problems. First, it was unnecessary to make specific reference to a "hazardous substance" since any tampering with such a substance would be ordinarily covered under the more general language. It was also somewhat difficult to imagine a scenerio where tampering with a hazardous substance would be a problem, since it is by definition a dangerous product. Furthermore, the language covered a broad range of products which do not seem to be, or likely to be, the subject of tampering incidents, such as stereos, vacuum cleaners, and other household appliances.

For this reason, the committee adopted most of the language from the definition of "consumer commodity" in the Fair Packaging Act, 15 U.S.C. 1459(a), essentially limits the bill's coverage to retail items which would be expended in the course of consumption or use.[16] Thus, it would cover most items normally found on a grocery store shelf which might invite the attention of a potential tamperer, such as household cleaners and soap.

The committee did not agree with the suggestion that the bill should cover only food, drugs, cosmetics, and devices.[17] The Department of Justice expressed "apprehension" about the inclusion of other products since it was not aware of any "significant" tampering with such products to date. The committee believes that it would be imprudent to fail to anticipate such incidents. Furthermore, the division between "food," "drugs," "cosmetics," and "devices," and other products was not made in title 21 with the tampering problem in mind. While those terms are convenient for drafting purposes, the committee believes that they should not be dispositive of the bill's coverage. The language based on the Fair Packing Act definition of "consumer commodity" addresses the concern expressed by the Justice Department, while drawing a reasonable line with respect to which products would likely be targets of tampering and which should, therefore, be covered for deterrence purposes.

Proposed subsection (e)(2) defines "food" by incorporating by reference the definition contained in section 201(f) of the Federal Food, Drug and Cosmetic Act (21 U.S.C. 321(f), which covers "(1) articles used for food or drink for man or other animals, (2) chewing gum, and (3) articles used for components of any such articles." It emphasizes that that definition is intended to include "meat food product," "poultry," "poultry product," "egg product," and "egg," as those terms are defined, respectively, in the Federal Meat Inssection Act (21 U.S.C. 601(j)), the Poultry Products Inspection Act (21 U.S.C. 453 (e), (f)), and the Egg Products Inspection Act (12 U.S.C. 1033 (f), (g)). However, the very broad definition of "food" incorporated into the bill clearly includes those items, even though the regulatory provisions of the Federal Food, Drug and Cosmetic Act may not otherwise cover items included in that definition. Moreover, the definition of "food" would cover tampering with drinking water sources where other requirements of the bill were met.

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[16] The committee's language does not incorporate the exclusions present in the Fair Packaging Act definition.

[17] Justice Department testimony at 9.

Proposed paragraphs (3) through (6) of subsection (e) incorporate by reference the terms "drug," "device," "cosmetic," and "labeling" from the Federal Food, Drug and Cosmetic Act (21 U.S.C. 321 (g) (1), (h), (i), (m)). Proposed subsection (e)(7) defines "serious bodily injury" as bodily injury which involves a substantial risk of death, extreme physical pain, protracted and obvious disfigurement, or protracted loss or impairment of the function of a bodily member, organ, or mental faculty. This definition, which triggers increased penalties for a tampering offense under proposed section 1365(a), is identical to the definition in section 831 of title 18, United States Code, which creates offense relating to nuclear materials.

SECTION 3

Section 3 of the bill amends that table of sections at the beginning of chapter 65 of title 18 to reflect the addition of the proposed section 1365.

VII. Regulatory Impact Statement

In compliance with paragraph 11(b), rule XXVI of the Standing Rules of the Senate, the committee has concluded that the bill will have no regulatory impact.

VIII. Cost of Legislation

In accordance with paragraph 11(a), rule XXVI of the Standing Rules of the Senate, the committee offers the following report of the Congressional Budget Office:

U.S. Congress,
Congressional Budget Office,
Washington, D.C., April 18, 1983.

Hon. Strom Thurmond,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: Pursuant to section 403 of the Congressional Budget Act of 1974, the Congressional Budget Office has reviewed S. 216, the Federal Anti-Tampering Act, as ordered reported by the Senate Committee on the Judiciary, April 12, 1983.

Based on this review, it is expected that no significant additional cost would be incurred by the Federal Government as a result of enactment of this legislation. The bill establishes penalties for various acts that result in malicious injury from adulterating a product or that convey false information concerning an attempt to commit such an act.

Enactment of this bill would not affect the budgets of State and local governments.

Should the committee so desire, we would be pleased to provide further details on this estimate.

Sincerely,

James Blum
(For Alice M. Rivlin, Director).

IX. Changes in Existing Law

In compliance with paragraph 12, rule XXVI of the Standing Rules of the Senate, changes in existing law made by S. 216, as reported, are shown as follows (new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

UNITED STATES CODE

Title 18.—Crimes and Criminal Procedure

* * * * * * *

CHAPTER 65—MALICIOUS MISCHIEF

Sec.

1361. Government property or contracts.
1362. Communication lines, stations or systems.
1363. Buildings or property within special maritime and territorial jurisdiction.
1364. Interference with foreign commerce by violence.
1365. Tampering with household products.

* * * * * * *

§ 1365. Tampering with household products

(a) Whoever, with intent to kill, injure or otherwise endanger the health or safety of any person or to cause significant damage or injury to the business of an individual, partnership, corporation, association, or other business entity, tampers with and thereby taints, or tampers with and thereby renders materially false or misleading the labeling of, or container for, any household product which is in, is intended to be in, or continues to affect interstate or foreign commerce, or attempts, threatens, or conspires to do so, shall—

(1) be imprisoned for not more than ten years or fined not more than $20,000, or both;

(2) if serious bodily injury results, be imprisoned for not more than twenty years or fined not more than $50,000 or both; and

(3) if death results, be imprisoned for any term of years or for life or fined not more than $100,000, or both.

(b)(1) Whoever imparts or conveys false information, knowing the information to be false, concerning an act or attempted act which, if true, would constitute a violation of subsection (a) shall be imprisoned for not more than one year or fined not more than $10,000, or both.

(2) Whoever willfully and maliciously imparts or conveys false information, knowing the information to be false, concerning an act or attempted act which, if true, would constitute a violation of subsection (a) shall be imprisoned for not more than five years or fined not more than $25,000, or both.

(c) A violation of this section may be investigated by the Federal Bureau of Investigation and by any other Federal agency which has investigative jurisdiction over such violation under title 21 of the United States Code.

(d) A person has the intent required for an offense under this section if the person knows or has reason to know that the normal and usual consequence of the actual, attempted, planned, or threatened tampering would be to kill, injure, or otherwise endanger the health or safety of any person or to cause significant damage or injury to the business of an individual, partnership, corporation, association, or other business entity.

(e) As used in this section—

(1) the term "household product" means—

(A) any food, drug, device, or cosmetic; or

(B) any article, product, or commodity of any kind or class which is customarily produced or distributed for sale

through retail sales agencies or instrumentalities for consumption by individuals, or use by individuals for purposes of personal care or in the performance of services ordinarily rendered within the household, and which usually is consumed or expended in the course of such consumption or use;

(2) the term "food" has the definition given such term in section 201(f) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(f)) and also includes "meat food product" as such term is defined in section 2(j) of the Federal Meat Inspection Act (21 U.S.C. 601(j)), "poultry" as such term is defined in section 4(e) of the Poultry Products Inspection Act (21 U.S.C. 453(e)), "poultry product" as such term is defined in section 4(e) of the Poultry Products Inspection Act (21 U.S.C. 453(f)), "egg product" as such term is defined in section 4(f), of the Egg Products Inspection Act (21 U.S.C. 1033(f)), and "egg" as such term is defined in section 4(g) of the Egg Products Inspection Act (21 U.S.C. 1033(g));

(3) the term "drug" has the definition given such term in section 201(g)(1) of the Federal Food, Drug, and Cosmetic Act, (21 U.S.C. 321(g)(1));

(4) the term "device" has the definition given such term in section 201(h) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(h));

(5) the term "cosmetic" has the definition given such term in section 201(i) of the Federal Food, Drug, and Cosmetic Act (21 U.S.SC. 321(i));

(6) the term "labeling" has the definition given such term in section 201(m) of the Federal Food, Drug, and Cosmetic Act (21 U.S.C. 321(m)); and

(7) the term "serious bodily injury" means bodily injury to a person which involves—

(A) a substantial risk of death;

(B) extreme physical pain;

(C) protracted and obvious disfigurement; or

(D) protracted loss or impairment of the function of a bodily member, organ, or mental faculty.

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Calendar No. 116

98TH CONGRESS
1st Session

SENATE

REPORT
No. 98–70

SHOPPING CENTER PROTECTIONS IMPROVEMENTS ACT OF 1983

MAY 4, (legislative day, MAY 2) 1983.—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 549]

The Committee on the Judiciary, which considered the bill (S. 2297) to make certain changes in Public Law 95–598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

PURPOSE OF THE BILL

The purpose of S. 549 to make changes in Public Law 95–598, the Bankruptcy Reform Act of 1978 ("the 1978 Act"). The 1978 act enacted the Bankruptcy Code (the "Code"), which contains the substantive law of bankruptcy, and a number of other provisions relating to bankruptcy administration. The changes made by S. 549 are not intended to alter any of the basic purposes or policies of the 1978 act. Instead, they are intended to clarify and improve certain protections for shopping centers and their solvent tenants which were enacted by Congress in the code, but which have proven ineffective. S. 549 will protect the common interests of all parties tenants, and landlords, when a shopping center tenant bankruptcy occurs. As a result of the unintended consequences of the 1978 act, one shopping center tenant's bankruptcy can threaten the profitability and the existence of a shopping center and all the other tenants of the shopping center. S. 549 would eliminate those unintended consequences.

INTRODUCTION AND HISTORY OF S. 549

This report explains pertinent aspects of the U.S. shopping center industry and how the 1978 act and S. 549 apply to this essential industry. Shopping centers are made up of many commercial enter-

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prises, a few large but many small. The success of these businesses is dependent upon the success of the center as a whole and upon the successful operation of the agreements entered into by the shopping center tenants and landlord to insure that all the parties cooperate for their mutual benefit.

In the 1978 act, Congress enacted section 365 of the Bankruptcy Code. The legislative history and the text of this provision make indisputably clear that Congress recognized and sought to deal with the potential harm to shopping centers and their solvent tenants which arises when one tenant becomes bankrupt and, therefore, is entitled (or his trustee is entitled) to assume or assign his lease. In effect, Congress recognized that shopping center tenants are inextricably tied together. When one suffers financial failure, neighboring tenants may be placed in jeopardy as well if the Bankruptcy Code does not provide an efficient arrangement to fill the vacancy.

Prior to the enactment of the code, the interests of the nonbankrupt tenants and the landlord were protected by the contractual power of the lessor to terminate the lease in the case of a tenant bankruptcy. When Congress eliminated this power in the 1978 act, it sought to establish other protections. Unfortunately, these protections have not carried out the congressional intent. As a result, in the years since the enactment of the 1978 act, it has become possible for the trustee in bankruptcy, or the bankrupt himself:

(1) To fail to decide whether he wishes to assume or reject the lease for an extended period of time, and to leave the premises unused or partially unused to the detriment of the surounding businesses and the landlord;

(2) To fail to perform his obligations under the lease when due, including the payment of rent and other charges; and

(3) To fail to asign his lease, when he does asign if, to an assignee who will use the premises as the lease requires.

When any one or more of these three situations occur, the economic health of the entire shopping center is threatened. S. 2297 strengthens the protections in the 1978 act against these three situations to make their occurrence less likely and deals with other more technical problems with the 1978 act.

THE BANKRUPTCY REFORM ACT OF 1978

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the 1978 act, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments, was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. On October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95–598. On October 1, 1979, it went into effect.

Prior to the enactment of the code, the bankruptcy law was contained in the Bankruptcy Act.[1] Under the Bankruptcy Act, in the

[1] The Bankruptcy Statute of 1898, Ch. 541, 30 Stat. 544 (1898), as amended.

case of the bankruptcy of a tenant, a shopping center was generally able to protect its interests and the interests of its other tennts by enforcing lease clauses permitting the lessor to regain control of the leased space. These lease clauses typically provided that if insolvency proceedings were initiated, the lessor could: (1) terminate the lease; (2) change the lease to a month-to-month tenancy; (3) waive or terminate an option to renew the lease; or (4) terminate the lease if the debtor was unable to maintain a certain sales volume or net worth.

Although some judicial decisions raised questions regarding the enforceability of such contractual agreements, these provisions usually enabled shopping centers to avoid damaging vacancies caused by the insolvency of a tenant.

SECTION 365 OF THE BANKRUPTCY CODE: LANGUAGE, STRUCTURE AND LEGISLATIVE HISTORY

Section 365 of the Bankruptcy Code relates to executory contracts and unexpired leases. Subsections (a), (b)(1), (b)(3), (d)(1), (d)(2), (e)(1), (f)(1) and (f)(2) are of primary importance regarding unexpired shopping center leases. These sections provide as follows:

> (a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
>
> (b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not asume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—
>
> (A) cures, or provides adequate assurance that the trutee will promptly cure, such default;
>
> (B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and
>
> (C) provides adequate assurance of future performance under such contract or lease.
>
> * * * * * * *
>
> (b)(3) For the purposes of paragraph (1) of this section, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—
>
> (A) of the source of rent and other consideration due under such lease;
>
> (B) that any percentage rent due under such lease will not decline substantially;
>
> (C) that assumption or assignment of such lease will not breach substantially any provision, such as a radius, location, use, or exclusivity provision, in any other lease, financing agreement, or master agreement relating to such shopping center; and
>
> (D) that assumption or assignment of such lease will not disrupt substantially any tenant mix or balance in such shopping center.
>
> * * * * * * *

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such contract or lease is deemed rejected.

(d)(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract or lease, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(e)(1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated on modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

* * * * * * *

(f)(1) Except as provided in subsection (c) of this section, notwithstanding a provision in an executory contract or unexpired lease of the debtor, or inapplicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection.

(f)(2) The trustee may assign an executory contract or unexpired lease of the debtor only if—

(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and

(B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been a default in such contract or lease.

Subsection (e)(1) makes termination clauses unenforceable. Subsections (b)(1) and (f) permit the trustee to assume or assign an unexpired lease subject to other provisions of this section. Subsection (b)(1)(C) and (f)(2)(B) require adequate assurances of future performance in the case of the assumption or assignment, respectively, of an unexpired lease. Subsection (b)(3) makes explicit what specific assurances of future performance are required in the case of a shopping center lease.

By these provisions, a trustee's option to assume an unexpired shopping center lease after the lessee's default is limited not only by the general provisions of subsection (b)(1), but also by the specific "shopping center" provisions of subsection (b)(3). The purpose of these provisions is to insure that an unexpired shopping center lease is assumed by the trustee only if the trustee provides adequate assurance

of future adherence to the lease. The code requires that performance to include assurances of the source of rent, assurances that percentage rents would not decline substantially (because of reduced sales), assurances that the use provisions contained in any other lease, financing agreement or master agreement would not be substantially breached, and assurances that the tenant mix would not be substantially disrupted.

Congress clearly intended to provide special protections for shopping centers and their solvent tenants when a trustee elects to assume an unexpired lease. Congress ackowledged the unique interrelationships of shopping center tenants and the potential ripple effect of a tenant bankruptcy on a shopping center and its solvent tenants by making shoping centers are the only kind of property protected with specific provisions of the 1978 act, section 365(b)(3). An examination of the legislative history of these provisions explains and provides further support for the proposition that Congress intended to prevent shopping centers and their solvent tenants from being unnecessarily injured in the event that one tenant became insolvent.

As introduced, section 365(b)(1) and (f)(2) of H.R. 8200 required that "adequate assurances" of future performance be provided the lessor in the case of either an assumption or assignment by a trustee of an unexpired lease. The shopping center industry argued that this requirement was too vague to solve effectively the problems which would be encountered by shopping centers in the event of the assumption or assignment of a lease.

The House Judiciary Committee responded to these arguments by including the following language in its report:

> The unenforceability of ipso facto or bankruptcy clauses proposed under this section will require the courts to be sensitive to the rights of the nondebtor party to executory contracts and unexpired leases. If the trustee is to assume a contract or lease, the courts will have to insure that the trustee's performance under the contract or lease gives the other contracting party the full benefit of his bargain. An example of the complexity that may arise in these situations and the need for a determination of all aspects of a particular executory contract or unexpired lease is the shopping center lease under which the debtor is a tenant in a shopping center.
>
> A shopping center is often a carefully planned enterprise, and though it consists of numerous individual tenants, the center is planned as a single unit, often subject to a master lease or financing agreement. Under these agreements, the tenant mix in a shopping center may be as important to the lessor as the actual promised rental payments, because certain mixes will attract higher patronage of the stores in the center, and thus a higher rental for the landlord from those stores that are subject to a percentage of gross receipts rental agreement. Thus, in order to assure a landlord of his bargained for exchange, the court would have to consider such factors as the nature of the business to be conducted by the trustee or his assignee, whether that business complies with the requirements of any master agreement, whether the

kind of business proposed will generate gross sales in an amount such that the percentage rent specified in the lease is substantially the same as what would have been provided by the debtor, and whether the business proposed to be conducted would result in a breach of other clauses in master agreements, relating, for example, to tenant mix and location.

H.R. Rept. No. 595, 95th Congress, 1st session, 348–349 (1977).

The Senate Judiciary Committee also responded to these concerns by incorporating the following in S. 2266:

* * * * * * *

(b)(3) The provisions of paragraph (1) of this subsection shall not prevent termination of a lease pursuant to provisions contained therein—

(A) in a case under chapter 7 of this title;

(B) where the lease was entered into before the effective date of this title;

(C) where the property leased thereunder is not essential to the debtor's business;

(D) where the rent payable pursuant to the lease is substantially less than the fair rental value of the property leased thereunder; or

(E) where the lease contains provisions for rent contingent upon the lessee's profits or sales and the rent otherwise set forth in the lease was substantially less than the fair rental value of the property at the time the lease was entered into.

* * * * * * *

(b)(5) For purposes of this subsection, "adequate assurance" shall include with regard to an unexpired lease of the debtor reasonable assurance—

(A) of the source of rental payments and other consideration due and owing to the landlord under the lease agreement;

(B) that there will be no substantial decline in any percentage rates specified by the lease;

(C) that the assignment or assumption of the lease will not substantially breach clauses (including, but not limited to, radius, location, use, and exclusive clauses) in other leases, financing agreements, or a master agreement relating to the leased and adjoining leased premises; and

(D) that an assumption or assignment of a lease will not disrupt the tenant mix of balance in property subject to multiple individual leases and an overall master agreement.

Further, the Senate committee made clear in its report that subsection (b)(5) was intended to assist shopping centers:

Subsection (b)(5) provides that in lease situations common to shopping centers, protections must be provided for the lessor if the trustee assumes the lease, including protection against decline in percentage rents, breach of agreements with other tenants, and preservation of the tenant mix. Pro-

> tection for tenant mix will not be required in the office building situation.

S. Rept. No. 989, 95th Congress, 2d session, 59 (1978).

By agreement of the Senate and House floor managers of this legislation, a compromise bill was introduced which contained the language in subsection (b)(3) and which was ultimately enacted.

In the Senate and House debates on the compromise bill, this provision was described as follows:

> Section 365(b)(3) represents a compromise between H.R. 8200 as passed by the House and the Senate amendment. The provision adopts standards contained in section 365(b)(5) of the Senate amendment to define adequate assurance of future performance of a lease of real property in a shopping center.

124 Cong. Rec. S17409 (daily ed., Oct. 6, 1978) (remarks of Senator DeConcini); 124 Cong. Rec. H11093 (daily ed., Sept. 28, 1978) (remarks of Mr. Edwards).

Legislative History: The Shopping Center Protections Improvements Act of 1982, S. 2297

In March 1982, the Shopping Center Protections Improvements Act of 1982, S. 2297, was introduced by Senators Hatch and DeConcini and was subsequently co-sponsored by Senators East and Baucus of the Senate Subcommittee on Courts and by several other members of the Judiciary Committee. The bill was strongly supported by the shopping center industry. Individual shopping center landlords and tenants and the trade associations representing shopping center landlords, tenants and financiers testified in support of the bill.

Hearings were held in Washington, D.C., on May 3, 1982.

S. 2297 was unanimously voted out of the Subcommittee on Courts on May 21, 1982, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto.

On August 4, 1982, with a quorum present, the full Judiciary Committee by voice vote ordered the bill favorably reported having previously agreed to five amendments.

On October 1, 1983, S. 2297 was unanimously passed by the Senate. This legislation is identical to S. 2297 as passed by the Senate, with the exception of technical amendments which exempt residential leases from the provisions of this bill.

On April 19, 1983, with a quorum present, the full Judiciary Committee unanimously ordered the bill favorably reported, having previously agreed to the technical amendments.

Background and Need for Legislation

The Bankruptcy Code, enacted by the Bankruptcy Reform Act of 1978, was the first major revision of the bankruptcy laws of the United States since 1938, and its enactment was the culmination of an effort that extended over a number of years. The code made numerous substantive changes in the law of bankruptcy as well as in the administration of bankruptcy cases.

One of these changes made unenforceable lease clauses permitting a landlord to regain possession of premises leased to a bankrupt tenant. However, Congress recognized the unique interrelationship between shopping center tenants and the great potential for harm to shopping centers and their solvent tenants arising from the ability of a bankrupt tenant to assume or assign a shopping center lease. To protect this important sector of the economy from unnecessary economic harm, Congress enacted in section 365 of the Code certain protective provisions for shopping centers and their tenants. Unfortunately, these provisions have not accomplished these purposes. As a result, this committee has reported S. 2297 to carry out Congress intent as stated in the 1978 act and to strengthen the protections for shopping centers under the Bankruptcy Code.

SHOPPING CENTERS ARE UNIQUE REAL ESTATE ARRANGEMENTS WHICH SUBSTANTIALLY BENEFIT THE ECONOMY

Shopping centers are an important sector of U.S. retail trade. In 1982 in the United States there were approximately 23,300 shopping centers with an estimated 1,285,300 retail stores. Approximately 44 percent of all U.S. retail trade amounting to $473 billion was conducted in shopping centers. In the coming year, 60 percent of all new retail space and 85 percent of new department store space is likely to be constructed in shopping centers.

The problems for shopping centers and their tenants caused by the present administration of the Code are serious and widespread. Conservatively estimated, 15,400 shopping centers have had one or more tenants involved in bankruptcies in 1982. Under this estimate, approximately 65 percent of all shopping centers were involved with the bankruptcies of 17,450 retail stores.

In a shopping center, the public benefits from the convenience and efficiency of "one-stop" shopping and frequently from the direct competition among the retail merchants who are tenants of the shopping center. The commercial success of the enterprise depends on the ability of all of the tenants to benefit each other by attracting potential customers. The shopping center is defined by its "tenant mix" which is carefully designed to serve a "trade area" and to draw sufficient customers from that trade area to support the rents paid by the tenants.

To make this enterprise work, each tenant must fully operate its store for a minimum of hours, engage in specified lines of business, advertise in ways that draw customers to the shopping center, and maintain certain standards of appearance and operation. This joint effort is cemented by a series of master agreements, entered into by all the parties involved in a shopping center, that set forth in precise terms the rights and obligations of each party.

As shopping centers have evolved, they have become larger and more sophisticated in design, construction and concept, involving tens of millions of dollars of investments by developers, tenants, and financial institutions. Once again, the linchpin of this entire operation is the freely accepted and openly negotiated contractual agreements among the parties.

While the operation of the bankruptcy law necessarily alters contractual relationships, these alterations have direct and potentially

crippling impacts on other shopping center businesses, and consequently, must be strictly limited and minimized. Accordingly, the committee has favorably reported S. 2297.

SHOPPING CENTER TENANTS AND THEIR LEASES ARE UNIQUE IN THEIR INTERDEPENDENCE

As Congress recognized in enacting the 1978 act, shopping center leases are distinct from other leases of real property in that each lease arrangement memorializes not only the bilateral interests of the tenant and the landlord, but the multilateral relationships of every other tenant in the shopping center. The interdependence among the tenants of a shopping center means that the bankruptcy of one tenant will seriously affect the other tenants.

Shopping center leases frequently are made on a long-term basis in consideration of the large investment usually made by tenant in establishing their various enterprises. These long-term lease agreements put the landlord into a position unlike a merchandise creditor or a financial institutional lender. A shopping center landlord, unlike other creditors, cannot make periodic reviews of the financial condition of his customers and unlaterally terminate creditor loans whenever it appears that the customer's credit is impaired. These long-term contracts obligate both parties to honor their agreements to protect the delicate interrelationships which form the foundation for the shopping center's success.

Moreover, shopping center leases frequently contain "anchor" clauses which commit the tenant to a lease term only so long as another designated tenant remains in the shopping center. These provisions further manifest the symbiotic, interdependent nature of a shopping center.

Mr. Nathan B. Feinstein testifying before the Courts Subcommittee in 1982, capsulized this principle beautifully:

> Tenants locate in shopping centers based on the complementary ability of the various stores in the shopping center to draw customers. One looks to the advertising and the merchandising techniques of the larger stores (anchor stores) in choosing a shopping center. One considers carefully the cooperative advertising, the center promotions, and the parking and other common services. The shopping center and its tenant's association rely on a continuing stream of payments from tenant-shopkeepers to meet the snow removal, air conditioning, heating, parking lot maintenance, advertising, mortgage, tax and other obligations of the center. When the stream of payments is disrupted for a significant period of time, every shopowner suffers by the lack of maintenance and uncertain financial viability of the center. When an anchor store closes its doors and stops advertisements, the smaller stores suffer the lack of patronage. When Saks Fifth Avenue moves out as anchor store and John's Bargains moves in, the small independent fashion boutiques die. When the future of the center is in doubt, the businessman-tenant does not know how to order for the season.

These multifarious symbiotic relationships in the shopping center are in peril whenever any tenant suffer financial hardship or fails. The continued vitality of those relationships and the businesses in the center depends on the system or bankruptcy policies create to swiftly fill vacancies and fairly acknowledge the interests of remaining solvent tenants. Hearings on S. 2297 before the Subcommittee on Courts of the Senate Judiciary Committee, 97th Congress 2d Session (1982) (hereinafter "Hearings").

PROTECTION OF SOLVENT SHOPPING CENTER TENANTS IN THE EVENT OF THE BANKRUPTCY OF A TENANT

Prior to the enactment of the 1978 act, the interests of the shopping center and its other tenants were protected against prolonged damage from a single tenant's bankruptcy by the contractual power of the lessor to control the disposition of the lease. As stated earlier, however, the 1978 act made such lease clauses unenforceable. Nevertheless, Congress recognized the special bankruptcy problems in shopping centers by including in the code special provisions governing unexpired shopping center leases. These provisions specify various assurances which the trustee must make in order to assume or assign an unexpired lease of the debtor.

Unfortunately, experience with these provisions indicates that they have not functioned as originally intended by Congress. Under the Bankruptcy Code, the shopping center and its solvent tenants may suffer serious economic harm or even business failure if a bankrupt tenant closes its store for an extended period of time or assigns its lease to a business which does not conform to the lease's use clause thus disrupting the shopping center's tenant mix. These problems are compounded when the bankrupt tenant is a major store in the shopping center.

S. 549 seeks to make effective the protections that Congress intended to provide shopping centers and their tenants in the 1978 act. S. 549 accomplishes this by removing latent defects in certain provisions of the Bankruptcy Code. These perfecting amendments do not change the policy of the code; they implement that policy. By making effective these protections, the bill strikes the proper balance between the interests of the solvent tenants of a shopping center and its insolvent tenants.

PROBLEMS AND SOLUTIONS

At the May 3, 1982, hearing, testimony in support of S. 2297 was received from the International Council of Shopping Centers—the trade association of the shopping center industry—from individual shopping center developers, and from the president of the Frederick Maryland Shopping Center Merchants Association, a shopping center which had experienced tenant bankruptcies. In addition, a statement supporting the bill was submitted for the record by the National Retail Merchants Association, which represents the small business tenants of shopping centers. Hearings, supra.

At the January 24, 1983 hearing on this legislation, testimony in support S. 549 was received from the International Council of Shopping Centers and the president of the Frederick Shopping Centers Merchants' Association.

Shopping centers and shopping center tenants support this legislation because the administration of bankruptcies under the code has resulted in numerous cases where shopping center tenant space was left closed for an extended period of time, where the trustee did not perform the debtor's obligations under the lease, or where shopping center space was assigned to a business not in conformance with the use clause.

The purpose of the bill is to remedy several substantive and technical problems relating to the operation and assignment of shopping center tenant space which have arisen under the code. These problems and the bill's solutions to them are as follows.

1. Time limit to assume or reject lease

a. Problem.—Under the 1978 act, in a chapter 7 (liquidation) case the trustee is required to decide within 60 days of the order for relief whether to assume or reject an executory contract or unexpired lease. However, no time limit is established for cases outside chapter 7. Consequently, an extended period of time often passes before the trustee makes such a decision in a chapter 11 (reorganization) case. During this dead time, the trustee often does not operate the space, or operates it at a much reduced level, thereby causing substantial economic harm to other tenants in the shopping center.

The testimony of witnesses representing shopping centers and shopping center tenants at the hearings and the 1982 statement for the record of the National Retail Merchants Association (NRMA) make clear that this is one of the major problems of shopping centers and their tenants caused by the administration of tenant bankruptcies under the code.

The vacancy of any tenant space for an extended period of time can seriously disrupt an entire shopping center. Customer traffic is reduced not only by the decreased supply of products or services, but also by the less pleasant atmosphere caused by boarding up a portion of the shopping center. Where the vacant space is that of an anchor store, the effect on the shopping center and its other tenants can be devastating.

For example, in 1982, Mr. John Holmes, president of a shopping center merchant's association in Frederick, Md., testified "to explain the damage to the other tenants of the Frederick Shopping Center resulting from the closing of these stores and the inability of the shopping center to release this space to operating businesses for a period of time." He then recounted that one store in the Frederick center was vacant for over 9 months and another for nearly 5 months. He noted that: "I have difficulty understanding how other tenants * * * survived. Even the comparably short time [the bankrupt stores were closed] severely damaged the business of many of the merchants of this shopping center, and in many cases the stores have not yet recovered." Hearings, supra. He pointed out that some neighboring stores suffered 28 and 26 percent reductions in sales volume during the period the bankrupt's premises were vacant.

In his testimony in 1983, Mr. Holmes contrasted the difficulties the shopping center encountered in 1981 and 1982, caused by the closing of a failed store in a bankruptcy proceeding, with the lack of harm to the other tenants when a Woolco store closed in early 1983, but was not

involved in a bankruptcy proceeding. The Woolco space was promptly turned over to another store, and an extended vacancy was avoided.

The shopping center landlord is injured in these circumstances because shopping center leases usually provide for rent as a percentage of revenues. These clauses are beneficial because they provide the landlord a direct financial incentive to maximize the sales of all tenants by preserving the most productive tenant mix. When a store is closed, or operated at a reduced capacity, the shopping center landlord's revenues also decline.

Detailed testimony was received from shopping center tenants regarding the serious problems to their businesses caused by the ability of the trustee to close a store in a shopping center for an extended period of time without stating his intention regarding the disposition of the premises, and preventing the landlord from re-leasing the space to an operating business. Mr. Wallace R. Woodbury of Salt Lake City, Utah, testified that a tenant in his shopping center had filed under chapter 11 8 months previously, had still not submitted a reorganization plan, was not operating the premises and was not paying rent. One expert witness stated that it usually takes between 9 months and a year to get a determination concerning the assumption or rejection of a lease in a contested chapter 11 case.

During this time, the other tenants of a shopping center may be affected dramatically. The closing of even a single store in a shopping center may susbtantially reduce the revenues and increase the costs of the other tenants. Their revenues are reduced because the closing of a store in a shopping center, especially a major store, reduces the traffic flow through the shopping center.

The closing of a major tenant can also significantly increase the costs of the other tenants. In many shopping centers, common area charges are assessed each tenant on the basis of the tenant's percentage of total leased space. The closing of a major tenant substantially reduces the amount of total leased space. This increases the percentage of total leased space of all the remaining tenants and their share of the common area charge.

Mr. Howard C. Oliver of Jim Wilson & Associates in Montgomery, Ala., summarized the problem of delayed assumption as follows:

> [The law allows] open ended and often lengthy delays in the decision by the trustee or debtor-in-possession to assume or reject a shopping center lease. This often results in an extended period when a store is vacant, and this hurts the business of the other tenants and forces the shopping center and the other tenants to bear some of the costs of the bankruptcy. Hearings, supra.

b. Solution.—The bill reduces the severity of these problems by imposing a 60-day time limit on the trustee's decision to assume or reject a nonresidential lease in cases under any chapter of the code, unless the court, for cause, allows additional time. This puts the burden of justifying an extension on the party best equipped to gage the length of time necessary to make an assumption decision.

A distinction between residential and nonresidential leases is made here and in other provisions of this subtitle. The application of these provisions is limited to nonresidential leases in order to avoid depriv-

ing residential tenants of whatever consumer protections they may have under applicable nonbankruptcy law.

In all but the most complicated reorganization cases 60 days should be a sufficient period to make this determination. Even in large reorganization cases, the debtor presumably knows his own business and understands the value of his assets well enough to make such decisions in 60 days. Also, the debtor is generally well aware in advance that a bankruptcy may be necessary and can plan ahead to decide which leases should be retained. The debtor should consequently be able to make this determination shortly after the petition is filed and certainly within 60 days in all but the most complicated cases. Nonetheless, the court has authority to grant extensions for cause.

2. Failure to perform lease obligations, including the payment of rent and other charges when due

a. Problem.—During the time the trustee is deciding whether to assume or reject the lease, the trustee frequently does ont meet the lease obligations, such as paying rent and other charges. As discussed above, the trustee's failure to pay common area charges often increases the costs of the shopping center's other tenants.

In addition, this situation often results in the landlord's providing current servies—the use of his property, and the provision of utilities and security to protect and preserve the leased property—without current compensation, a burden imposed on no other class of creditor. This burden is particularly onerous where the landlord needs the rent payments provided in the lease in order to make tax or mortgage payments on the property.

In reference to this problem, Mr. Wallace Woodbury testified that:

> This presents a hardship to a landlord who may not receive a rent for several months and is unable to gain control of his premises. I am not aware of any other class of person who is required to provide a service to the bankrupt estate without current compensation. Hearings, supra.

b. Solution.—The bill solves this problem by requiring the timely performance of nonresidential lease obligations, including the payment of rent and other charges. However, the bill permits the court to extend the time for performance of such payments to a date no later than 60 days after the order for relief. Such an extension could be granted where a trustee is unfamiliar with the operation of the debtor's business and there is reason to question his legal duty to pay rent or other charges or perform other obligations under the lease.

3. Compliance with use clauses and other provisions of the lease

a. Problem.—The code currently requires adequate assurances that the assumption or assignment of an unexpired lease will not breach "substantially" important provisions of shopping center leases (provisions such as "radius, location, use or exclusivity" clauses) and will not "substantially" disrupt the tenant mix. Congress thus intended to protect shopping centers and their solvent tenants from the consequences of the violation of use clauses and the disruption of the tenant mix. Also, it is clear that whatever the intended meaning of the term "substantially," it has been interpreted in a way which has frustrated

the congressional intent. While it may seem reasonable to someone to unfamiliar with shopping centers to permit the assignment of a women's wear store lease to a men's wear store, such an assignment can be commercially unreasonable because centers have a carefully planned ratio of men's wear to women's wear so that they complement each other. Such an assignment could be extremely damaging to the other men's wear store tenants as well as the other tenants in the shopping center. Frequently the rental provisions are based in large part on the use. The change in use leads to the damage Congress sought to prevent through the enactment of section 365(b)(3) of the code.

In practice, the qualification of the required assurances by the term "substantially" has led trustees or debtors-in-possession in some instances to ignore these lead clauses and, consequently, has permitted the disruption of the delicate interrelationships of the shopping center's tenant mix. In one case, the bankruptcy court permitted a tenant to change the use of its premises, a discotheque, to permit male striptease shows.[2] In another case, a bankrupt men's wear chain store assigned a number of leases to women's wear stores.[3] In another instance, advertisements for bids on shopping center space indicate that the term "substantially" permits gross deviations from the use clause. These advertisements, placed by lease brokers, state that "all retail uses" would be considered even though the leases involved had more limited use clauses.

The assignment of a lease to a business that does not conform to the use clause of that lease, especially in the case of a major store lease, can affect the other tenants much in the same way as the closing of the store. Where the misassignment occurs in the case of the major store in a strip center, the effect can be disastrous, substantially reducing the revenues of all the other tenants. For example, the assignment of the lease of a grocery store, with substantial and steady drawing power, to a toy store, with less ability to attract customers, would reduce the traffic of all of the other shopping center tenants.

In a regional mall with more than one major tenant, the misassignment of that lease will have less effect on the entire mall, but stores adjacent to it may suffer considerable reductions in customers. For example, replacing a small store with substantial customer attraction power—such as a women's wear store—with another business which generates less traffic would have an adverse effect on the adjacent stores.

Adjacent stores also can be severely hurt through violations of the use clause when a complementary use is replaced with a competing use. Mr. Wallace Woodbury, for example, testified regarding space he had leased to a record and tape store situated next to a TV and consumer electronics store. Immediately after exercising a lease renewal option the tenant filed a bankruptcy petition and vacated the premises. Despite the fact that the landlord had a replacement tenant with substantial assets who complied with the use restriction of the lease, the Trustee assigned the lease to a financially unsound shell corporation which sold substantially the same type of merchandise as the adjacent TV store. On taking posession the assignee immediately advertised

[2] *Reyco of Nevada* v. *Russel D. Johns*, 5 BCD 1074 (D. Nevada 1979).
[3] *In re Hughes & Hatcher, Inc.*, Case No. Bk. Ct. S.D.N.Y., No. 82B 101521 (JL).

"going out of business prices." After suffering 6 months of unfair and ruinous competition from the assignee tenant the TV store vacated the premises on the grounds that the landlord's exclusive commitment to it had been violated. Seven months later and after failing to pay substantial rent, the assignee tenant itself went out of business and abandoned the premises. In the words of Mr. Woodbury, "the landlord ended up with vacancies in two stores, the substantial loss of rental income, and considerable building damage and the nonbankrupt tenant lost substantial sums and was forced to abandon the shopping center because of the trustee's utter disregard of the lease provisions which were designed to protect both the landlord and the nonbankrupt adjacent tenant." Hearings, supra.

Preexisting stores also are disadvantaged if the rental payments of the assignee are lower than those of the preexisting stores. Stores in the same line of business are usually charged equivalent rents based on their business use. Women's wear stores usually pay lower rents than other stores because they tend to draw more customers to the shopping center than do other types of stores. Thus, if the lease of a bankrupt women's wear tenant is assigned to a mens' wear store, the assignee men's wear store may be paying less rent than will the preexisting competing men's wear stores.

Also, the preexisting men's wear stores may be harmed unfairly by the oversaturation of the men's wear market resulting from the assignment to an additional men's wear store. This deprives them of the benefit of their bargains with the developer which were based on an agreement on the number of men's wear stores to be included in the shopping center.

Senator Orrin G. Hatch, author of S. 549, succinctly explained this situation in his statement to the Courts Subcommittee in 1982:

> In the event the lease is assumed by the administrator, it may be assigned to a business not in full compliance with the use limitations of the lease * * *. For example, several men's shoe stores may have negotiated their leases with the shopping center understanding that all men's shoe stores would pay identical rent. Assigning a women's shoe store lease at a lower rent to another men's shoe store could both oversaturate the men's shoe store market and give the incoming store the unfair advantage of a lower overhead.

By disregarding a use clause in an assignment situation, the trustee is able to create and the sell an asset (the lease) that did not previously exist. This asset is not created out of thin air; rather, it is unfairly created at the expense of the landlord and the other tenants of the shopping center.

In many cases where the assignment of shopping center leases is a significant asset of the estate of the debtor, the debtor is a large chain store enterprise. Such enterprises negotiate with shopping center developers over lease provisions vigorously and from a position of strength. Use clauses and other lease provisions favorable to the landlord and other tenants are accepted as part of the lease by these tenants only because of the granting by the landlord of concessions in other terms of the lease. In the words of Nathan B. Feinstein, "[Use clauses] are almost always carefully drawn and extensively negotiated. More

important, they are relied upon by other tenants in the shopping center." Hearings, supra. Careful adherence to the provisions in use clauses is necessary to give all enterprises in a shopping center the benefit of their respective bargains. More important, strict compliance with the use clauses is needed to insure the other tenants that the center will be what they expected when they agreed to commit themselves and large amounts of capital to the center for a long period of time.

b. Solution.—By deleting the word "substantially," the bill makes clear that important lease provisions such as the use clause are to be honored and that the tenant mix is not to be disrupted. Not all shopping center leases contain restrictive use clauses, but where they are included in a lease they are necessary to define the tenant's business in relation to the other stores in the shopping center. Restrictions on the assignability of shopping center leases are justified by the use to protect the interests of the other tenants in the shopping center.

This provision does not unduly restrict the assignment of shopping center leases. Use clauses cannot be overly restrictive because they must permit enough flexibility to allow for the normal conduct of the original tenant's business. Mr. George Lambros of Missoula, Mont., who devoted his entire testimony to the use limitation problem, explained:

> It is important to note that deleting the word "substantially" from these provisions would in no way prevent the assignment by debtors of their leases. Although shopping center lease use provisions are drawn with various degrees of specificity, even the narrowest use description still covers a market segment served by a very large number of existing and potential businesses. Although requiring strict performance of the use clause of the lease will limit the universe of potential assignees of any shopping center lease space, this limitation is absolutely necessary for the health of the shopping center and its other tenants and does not place an unreasonable burden on the debtor. Hearings, supra.

Use clauses are not intended to prevent the assignment of leases and practice in the shopping center industry shows that they will be interpreted reasonably. Any attempt to preclude assignment by drafting a use clause which would apply only to the original tenant would be de facto prohibitions of assignment, and, therefore, would be unenforceable under section 365(f)(1).

Where the trustee is unable to find an assignee within the use clause who is willing to pay what the trustee considers an acceptable price for the lease, the committee believes that it is appropriate for the lease to revert to the landlord.

Even where the landlord also is unable to find a replacement tenant with the same business use as the debtor, the committee believes that it is preferable to have an alternate use determined by the landlord rather than by the trustee and the Bankruptcy Court. It is in the interest of the debtor to choose the assignee which will pay the highest amount for the lease and thus maximize the proceeds from the sale of the lease, regardless of the impact of the assignment on the other tenants. On the other hand, it is in the interest of the landlord to

select an assignee who will have the most beneficial effect on the business of the entire shopping center even though that assignee may not pay the highest rent. This is the case because shopping center landlords derive much of their income from percentage rents; that is, rents based on a percentage of the sales of the tenants. Thus, they have a strong incentive to select a tenant that will enhance the tenant mix and, thereby, increase the sales of all the tenants of the shopping center.

4. Operating and financial performance of assignee

a. Problem.—If shopping center space is assigned to a business in poor financial condition, the shopping center and its solvent tenants may soon find themselves dealing with another store in bankruptcy, with all of the attendant problems. As discussed above, when the trustee assigns space to a store in unsound financial condition, the harm to the landlord and the other tenants is compounded.

b. Solution.—Under the code, adequate assurances of the source of rent and other consideration due under the lease must be given. The bill makes clear that this includes assurances that the assignee has an operating and financial performance similar to that of the debtor when the lease was first executed. This provision was amended by the full Judiciary Committee in 1982 to insure that it would not be interpreted to mean that the assignee must have exactly the same financial posture as the assignor. Instead, the assignee should have a similar operating and financial performance when all factors, including advertising aggressiveness, profit margins, growth potential, and other financial indicia, are weighed.

5. Payment of security deposit by assignee

a. Problem.—In some cases, the assignee of a lease is not required to pay the customary security deposit. Security deposits provide an incentive for a shopping center tenant to keep his space in good repair, a requirement which benefits the entire shopping center enterprise.

b. Solution.—The bill provides that an assignee pay the same security deposit as would be required by the landlord, if the landlord was leasing the space.

TECHNICAL AMENDMENTS

1. Compliance with provisions of the lease assumed

a. Problem.—Some trustees have interpreted the code as providing that an assignee of a shopping center lease does not have to comply with the use and other important clauses contained in the lease being assumed, but only is bound to comply with such clauses contained in the other leases, financing agreements, and master agreements, relating to the shopping center. Such an incorrect interpretation would allow an assignee to violate the use clause of the lease. This interpretation clearly is contrary to the intent of this committee and works to the detriment of the shopping center and all of its solvent tenants.

b. Solution.—The bill confirms that under the code, the new tenant must comply with all the provisions of the lease being assumed, as well as the provisions of other agreements relating to the shopping center.

2. Application of protections in all assignment situations

a. Problem.—Specific protections are provided for shopping centers and their tenants by the code. However, due to a technical omission in

the code, these protections may be construed to apply only if there has been a default of the lease. This would permit a trustee to assign a lease in violation of these protections as long as he does not default on the lease.

b. Solution.—The bill confirms that these protections apply to any assignment of a shopping center lease, whether or not there has been a default.

3. Termination under State law

a. Problem.—If a lease is terminated under State law prior to the order for relief, by reason of its own terms or by judicial order, there is a potential ambiguity about its inclusion in the estate.

b. Solution.—The bill removes any possible ambiguity by clarifying that under existing law a nonresidential lease is no longer property of the debtor and should not be subject to the bankruptcy proceedings.

4. Termination by its own terms

a. Problem.—Where a lease terminates by its own terms; that is, where the term of the lease comes to an end at a date certain, potentially there is uncertainty as to whether any rights in the property become assets of the bankrupt's estate.

b. Solution.—The bill makes it clear that in such a case a nonresidential lease is not the property of the estate, that the automatic stay provisions of the code do not apply, and that the landlord can recover the premises as provided under State law.

Summary of S. 549 and Sectional Analysis

Summary of provisions of S. 549

1. S. 549 amends section 365 of the Bankruptcy Code to accomplish the following:

(a) Impose a 60-day limit on a trustee's acceptance or rejection of an unexpired nonresidential lease in all bankruptcy cases, which may be extended for cause.

(b) Require the trustee to perform all of the obligations of the tenant under a nonresidential lease, including the payment of rent and other charges specified in the lease, until the lease is assumed or rejected, unless the court extends the time for performance, for cause, up to 60 days after the petition is filed.

(c) Delete the word "substantially" from the provisions requiring that an assignment of a shopping center lease would not breach other agreements and would not disrupt tenant mix.

(d) Require that an assignee of a shopping center lease would have an operating and financial performance similar to that of the original tenant when the lease was executed.

(e) Allow the lessor, in the event of a lease assignment, to require his customary security deposit from the new tenant.

(f) Make clear that under existing law any assignment of a lease is subject to all of the provisions of the lease being assigned as well as the provisions in any other relevant document, such as a financing agreement.

(g) Provide that the special provisions for assignment of shopping center leases apply whether or not there has been a default under the lease.

(h) Clarify existing code language to make clear that nonresidential leases that have been terminated under State law will not be treated as property of the debtor and will not be subject to the administration of the bankruptcy court.

2. S. 549 amends section 541 of the Bankruptcy Code to make clear that property subject to a nonresidential lease which has expired by virtue of its own terms is not property of the estate and that a proceeding to obtain possession of such property is not automatically stayed by section 362 of the code.

SECTIONAL ANALYSIS

Section 1

This section provides that this title may be cited as "The Shopping Center Tenant Bankruptcy Protection Improvements Act of 1983."

Section 2

This section amends section 365 (a), (b), (c), and (d) and adds section 365(1) of title II, United States Code, as follows:

1. Section 365(a) is amended by adding the language:

> The trustee shall timely perform all the obligations of the tenant arising from and after the date of the order for relief, under an unexpired nonresidential lease (including payment of the rent and other charges specified in such lease) until such nonresidential lease is assumed or rejected, not withstanding the provisions of section 503 of this title. For cause shown, the court may extend the time for performance of any obligation of rent or other charges due upon an unexpired lease pursuant to the provisions of section 108(b) of this title. Acceptance of such performance shall not constitute a waiver or relinquishment of the lessor's rights under the lease or under this title.

The purpose of this amendment is to make clear that the trustee is responsible for paying postpetition rent and other charges and performing other obligations a nonresidential lease on a timely basis until the lease is assumed or rejected.

However, where a trustee, unfamiliar with the business of the debtor, is appointed to administer the estate, and where there is reason to question the requirement to pay rent or other charges or to perform other obligations of the estate under the lease, the trustee may petition the court, and, if cause can be shown, the court may extend the time for performance of such postpetition obligations to a date no later than 60 days after the order for relief. Under section 108(b), the trustee has 60 days after the order for relief to cure defaults and perform other similar acts.

A distinction between residential and nonresidential leases is made here and in the amendments to sections 365(c), (c)(3), (d)(1), (d)(2), (d)(3), and to section 541(b).

The application of these provisions is limited to nonresidential leases in order to avoid depriving residential tenants of whatever consumer protections they may have under applicable nonbankruptcy law.

This amendment also makes clear that the lessor's acceptance of such performance by the trustee does not constitute a waiver of relinquish-

ment of the lessor's rights under the lease or under the Bankruptcy Code.

2. Section 365(b)(3) has been amended to provide that adequate assurance of future performance of a shopping center lease applies not only where there has been a default, but whenever an unexpired lease is assigned. This change is necessary because, due to a technical omission in the Bankruptcy Code, the protections for shopping centers and their solvent tenants which are provided in section 365(b)(3) could be construed as not applying in a situation where the debtor has not defaulted on his lease and seeks to assign the lease in violation of the use clause or other provisions of the lease.

3. Section 365(b)(3)(A) is amended to require an adequate assurance that any assignee of the lease will have an operating and financial performance, including guarantors, similar to that of the original tenant when the lease was executed.

This provision is intended to prevent a shopping center lease from being assigned to another business in poor financial condition. Such a business might itself soon fail, resulting in a repetition of the problems caused by the bankruptcy of the assignor.

This provision gives the lessor and the other tenants the benefit of the original bargain with the debtor. Indicia of operating and financial performance include advertising effort, marketing style, profitability, debt rating, and ability to meet debt obligations.

4. Section 365(b)(3)(C) is amended to make clear that the assumption or assignment of a shopping center lease is subject to all the provisions of that lease, as well as to any other lease, financing agreement, or master agreement relating to the shopping center. Debtors have argued incorrectly that this provision only requires adequate assurances that the provisions of such "other" leases and agreements would not be breached, but that it would not require such assurances regarding the provisions of the lease being assigned.

5. Sections 365(b)(3)(C) and (D) are amended to delete the word "substantially" from provisions requiring that an assignment of a shopping center lease will not breach the assigned lease or other leases or agreements and will not disrupt the tenant mix.

In practice, the presence of the qualifier "substantially" has enabled trustees to ignore the use clause of leases. This violates the assigned lease and other agreements and, thereby, disrupts the tenant mix to the detriment of the other tenants of the shopping center. In 1978, Congress recognized the importance of compliance with the use clauses, and this amendment is necessary to effect Congress intent.

6. Section 365(c)(3) has been added to provide that the trustee may not assume or assign an unexpired nonresidential lease if "such nonresidential lease has been terminated under State law prior to the order for relief."

The purpose of this amendment is to provide that an unexpired nonresidential lease may not be assumed by a trustee, if such lease has been terminated by a State court judgment or otherwise under State law prior to the order for relief.

7. Section 365(d) has been amended to provide that in a case under any chapter of the Bankruptcy Code, an unexpired nonresidential lease of the debtor is deemed rejected if the trustee does not assume or reject

such lease within 60 days, or within such additional time as the court, for cause, orders.

In addition, this amendment provides that if a nonresidential lease where the debtor is the lessee is deemed rejected, "the court shall order the premises to be vacated immediately."

8. Section 365(l) is added, providing that if an unexpired lease is assigned, the lessor may require from the new tenant a security deposit for the performance of the obligations of the lease which is substantially the same as that required by the landlord upon the initial leasing and a similar tenant.

This amendment is intended to give the landlord the benefit of his original agreement with the debtor, and provide protection to the shopping center and its other tenants equivalent to that of the original bargain.

Section 3

This section amends section 541 of title 11, United States Code, to make clear that the debtor's interest in property subject to a nonresidential lease which has expired by virtue of its own terms is not property of the estate and that a proceeding to obtain possession of such property is not automatically stayed by section 362 of the code.

This amendment is intended to permit landlords to proceed promptly in State court to reclaim possession of nonresidential leased premises where such lease has expired by its own terms; that is, because a specified termination date of the lease has been reached. This change is intended to facilitate the ability of the landlord to re-lease the space to another tenant as soon as possible.

Budget and Regulatory Impact; Cordon Rule

A. BUDGET IMPACT

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B. REGULATORY IMPACT EVALUATION

In compliance with rule XXVI(11)(b) of the Standing Rules of the Senate, the committee finds that no significant regulatory impact as denied by that subsection will result from the enactment of S. 549.

C. CHANGES IN EXISTING LAW

In compliance with rule XXVI(12) of the Standing Rules of the Senate, changes in existing law made by the statutory provisions transmitted herein, are shown as follows (existing law proposed to be amended is enclosed in black brackets, new material is printed in italic, existing law in which no change is proposed is shown in roman):

BANKRUPTCY CODE

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Section 365. Executory contracts and unexpired leases.

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or

unexpired lease of the debtor. *The trustee shall timely perform all the obligations of the tenant arising from the and after the date of the order for relief, under an unexpired nonresidential lease (including payment of the rent and other charges specified in such lease) until such nonresidential lease is assumed or rejected, notwithstanding the provisions of section 503 of this title. For cause shown, the court may extend the time for performance of any obligation of rent or other charges due upon an unexpired lease pursuant to the provisions of section 108(b) of this title. Acceptance of such performance shall not constitute a waiver or relinquishment of the lessor's rights under the lease or under this title.*

(b)(1) If there has been a default in an excutory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default;

(B) compensates, or provides adequate assurance that the trustee will promptly compensate, a party other than the debtor to such contract or lease, for any actual pecuniary loss to such party resulting from such default; and

(C) provides adequate assurance of future performance under such contract or lease.

(2) Paragraph (1) of this subsection does not apply to a default that is a breach of a provision relating to—

(A) the insolvency or financial condition of the debtor *or the debtor's insider (excluding a credit guarantor or the debtor)* at any time before the closing of the case;

(B) the commencement of a case under this title; or

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(3) For the purposes of paragraph (1) of this section *and paragraph (2)(B) of section (f)*, adequate assurance of future performance of a lease of real property in a shopping center includes adequate assurance—

(A) of the source of rent and other consideration due under such lease [;]. *and in the case of an assignment, with an operating and financial performance, including guarantors, similar to that of the original tenant when the lease was executed;*

(B) that any percentage rent due under such lease will not decline substantially;

(C) that assumption or assignment of such lease *is subject to all the provisions thereof, including provisions such as a radius, location, use, or exclusivity provision, and* will not breach [substantially] *any* such provision [such as a radius, locations, use, or exclusivity provision,] *contained* in any other lease, financing agreement, or master agreement relating to such shopping center; and

(D) that assumption or assignment of such lease will not disrupt [substantially any tenant mix or balance in such shopping center.

(4) Notwithstanding any other provision of this section, if there has been a default in an unexpired lease of the debtor, other than a

default of a kind specified in paragraph (2) of this subsection, the trustee may not require a lessor to provide services or supplies incidental to such lease before assumption of such lease unless the lessor is compensated under the terms of such lease for any services and supplies provided under such lease before assumption of such lease.

(c) The trustee may not assume or assign an executory contract or unexpired *reidential or nonresidential* lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of right or delegation of duties, if—

(1)(A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to *an entity other than the debtor or the debtor in possession* or an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of right or delegation of duties; and

(B) such party does not consent to such assumption or assignment; or

(2) such contract is a contract to make a loan, or extend other debt financing accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

(3) *such non-residential lease has been terminated under state law prior to the order for relief.*

(d)(1) In a case under chapter 7 of this title, if the trustee does not assume or reject an executory contract or unexpired *non-residential* lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period fixes, then such contract or lease is deemed rejected.

(2) In a case under chapter 9, 11, or 13 of this title, the trustee may assume or reject an executory contract or unexpired *non-residential* lease of the debtor at any time before the confirmation of a plan, but the court, on request of any party to such contract, may order the trustee to determine within a specified period of time whether to assume or reject such contract or lease.

(3) In a case under any chapter of this title, if the trustee does not assume or reject an unexpired non-residential lease of the debtor within 60 days after the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and in the case of a non-residential lease of real property where the debtor is the lessee, the court shall order the premises to be vacated immediately."

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